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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613.

In the Matter of

VAN SWERINGEN CORPORATION,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY

(Formerly Midamerica Corporation),

Petitioner,

vs.

VAN SWERINGEN CORPORATION, Debtor,

and

FREDERICK L. LECKIE and JOSEPH G. FOGG, Trustees of Van Sweringen Corporation,

Respondents.

(A. B. GOCHENOUR, *et al.*, Intervenors.)

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

The writ of certiorari should not be granted because there is nothing presented except questions of fact which have been decided against Petitioner on five occasions by three lower tribunals.

PROCEDURE BELOW.

The matter was originally heard by a Special Master, upon objection by the Trustees of Van Sweringen Corporation to the claim of Midamerica in the amount of $13,787,000.00. The Master sustained the objections, made findings of fact and allowed the claim in the amount paid there-

for by Midamerica, namely $887.00 (R. 122). Midamerica then obtained leave to introduce additional evidence. (R. 258). After the introduction and consideration of the additional evidence, the Master filed an interim report recommending that the objections of the Trustees be sustained (R. 259). Upon exceptions and objections by Midamerica to the interim report, and after briefing and oral argument, the District Court rendered its opinion approving and adopting the findings and recommendations of the Special Master (R. 269) and made additional findings of fact (R. 278). Upon appeal by Midamerica to the Circuit Court of Appeals for the Sixth Circuit, and after submission of briefs and oral argument, the Circuit Court of Appeals rendered its decree April 16, 1941 affirming the District Court in all respects (R. 319); for opinion of the Circuit Court of Appeals see R. 320, also reported at 119 F. (2d) 231. Upon the petition by Midamerica for rehearing supported by brief, the Circuit Court of Appeals denied a rehearing (R. 341).

THE FINDINGS BELOW.

The three lower tribunals were in accord on these vital points:

1. That O. P. and M. J. Van Sweringen were officers and directors and in control of Van Sweringen Corporation.
2. That the Van Sweringens caused Midamerica Corporation to be formed for the purpose, among other things, of acquiring claims against Van Sweringen Corporation at a tremendous discount.
3. That Midamerica purchased $13,787,000.00 principal amount of notes of Van Sweringen Corporation for the sum of $887.00.
4. That no notice of such proposed purchase was given to creditors or stockholders of Van Sweringen Corporation.
5. That Van Sweringen Corporation was then insolvent, but had the financial ability to buy these notes at the cost to Midamerica.

6. That those in control of Van Sweringen Corporation took no steps to protect its interests or to cause it to acquire the notes.
7. That O. P. and M. J. Van Sweringen stood to derive a personal profit from such purchase.

The District Court specifically found (R. 278-279):

"2. The plan and scheme which culminated in the option agreement of September 21, 1935, and in the formation of Midamerica Corporation, was that of O. P. Van Sweringen and M. J. Van Sweringen. The essentials of such plan had appeared in plans prepared by O. P. Van Sweringen and M. J. Van Sweringen or in their office and under their direction prior to the time when they approached George A. Ball and G. A. Tomlinson, and were neither originated nor dictated by Messrs. Ball and Tomlinson.

* * *

5. O. P. Van Sweringen and M. J. Van Sweringen acquired valuable rights and stood to profit personally by means of the option agreement of September 21, 1935, and their interest in and employment by Midamerica Corporation. The option agreement was a device for placing the interests of O. P. Van Sweringen and M. J. Van Sweringen in the purchased securities and obligations beyond the reach of their creditors.

6. The cost to Midamerica Corporation of the $13,787,000.00 principal amount of notes, to-wit, $887.00, was not a fair consideration for these notes."

The Circuit Court of Appeals in its opinion, after stating that the District Court had allowed this claim in the amount of $887.00, partially summarized the facts as follows (R. 320):

"The District Court found that the foregoing allowances were the amounts shown on the books of Midamerica Corporation as the purchase price of the notes and bonds of the respective debtors acquired by Midamerica at auction sale on September 30, 1935; that Midamerica Corporation was a combination in corporate form, participated in by directors of the respec-

> tive debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against them at a sacrifice for the profit of the combination at the expense and to the detriment of the debtor corporations; that the debtor companies were insolvent on the date of the auction sale and could not meet their maturing obligations, their assets at a fair valuation not equaling their liabilities; that bad faith and breach of fiduciary duty were implicit in the purchases by the officers of the Company of the corporate securities for their personal advantage; that the Midamerica Corporation acquired and holds the notes and bonds as trustee for the respective debtor corporations and that appellant, as its successor, is entitled to allowance of its respective claims only for the amounts paid for the same, together with interest thereon. *We find that the record in each of the three cases abundantly supports these findings of the District Court.*" (Emphasis ours.)

The Circuit Court of Appeals further held that the Van Sweringens, as directors of insolvent corporations, in association with outside enterprisers, purchased these claims against their *cestui que trust* "at substantially less than real values" (R. 325).

This Court has repeatedly held that certiorari will not be granted merely to review inferences drawn from the evidence, and that where two lower courts have concurred in deciding questions of fact, such findings will not be disturbed where there is evidence to support them.

> *Texas & New Orleans Railroad v. Brotherhood of Railway Clerks*, 281 U. S. 548;
>
> *General Talking Pictures Corporation v. Western Electric Company*, 304 U. S. 175 at 178;
>
> *Just v. Chambers*, 61 S. Ct. 687, 85 L. Ed. 569, decided March, 1941.

These findings have ample support in the evidence in this case.

THE RECORD SUPPORTS THESE FINDINGS.

O. P. and M. J. Van Sweringen were directors and officers and were in control of Van Sweringen Corporation (R. 24, 25, 37, 279). O. P. and M. J. Van Sweringen were also directors and in control of Vaness, which owned the controlling stock of Van Sweringen Corporation (R. 24, 25, 36).

The notes in question were part of an issue of $30,000,000.00 principal amount, issued in May 1930 by Van Sweringen Corporation, respondent herein. The total issue was purchased by the general public (R. 25). About a year and a half later Van Sweringen Corporation repurchased $15,000,000.00 principal amount of these notes from the general public, paying approximately $500.00 in cash and 20 shares of common stock of Van Sweringen Corporation for each $1,000.00 note. These notes were retired, leaving $15,000,000.00 principal amount outstanding (R. 26). Of these, $1,213,000.00 principal amount still remain in the hands of the public (R. 27), and have been allowed in these proceedings as a valid claim. The remaining $13,787,000.00 principal amount of notes for which Midamerica paid $887.00 are the subject of this proceeding.

The repeated unsuccessful efforts of O. P. and M. J. Van Sweringen (referred to at page 4 of Petitioner's Brief) to refund or extend the Vaness and C. T. B. notes in the amount of $16,000,000.00 and $23,500,000.00 respectively, consisted of attempts to coordinate all of the indebtedness in which they were interested, which included other obligations of their personal holding company (Vaness), their own personal debts and debts of many of their other companies, aggregating $76,000,000.00 worth of indebtedness. These efforts had these principal objectives: (1) to release the Van Sweringens from their guarantees of the Vaness and C. T. B. notes; (2) to cancel certain other personal indebtedness approximating $17,000,000.00; (3) to enable O. P. and M. J. Van Sweringen to retain control of their

various enterprises and (4) to avoid the imposition of large personal income taxes upon the Van Sweringens. (R. 156-158, 186 offered 158 Stip. 18D, 278).* Some 26 drafts of plans were prepared (R. 206).

On the very day the Morgan loans became due, i.e. May 1, 1935, the Van Sweringens wrote J. P. Morgan & Company stating that the loans would not be paid and that a sale of the collateral would be necessary (R. 181 offered 151 Stip. 3). The Van Sweringens then devised numerous plans for the purpose of acquiring that portion of the collateral representing the Van Sweringen enterprises, which was later put in groups 1 and 3 and was finally acquired by Midamerica at auction sale (R. 229 offered 212, 239 offered 219, 240 offered 219, 255 offered 219).

By letter of July 20, 1935 the Van Sweringens personally offered to buy at private sale from J. P. Morgan & Company for $2,275,000.00, through the medium of furnishing a purchaser, the Vaness and C. T. B. notes and approximately that portion of the collateral which was finally purchased by Midamerica (R. 188 offered 158 Stip. 18E). A week or ten days later, but before there was any discussion with Ball or Tomlinson, a plan was prepared in the office of O. P. Van Sweringen, which contains almost the exact language of the option agreement which Ball and Tomlinson finally made with the Van Sweringens (R. 215, 253 offered 219).

In early August, 1935, J. P. Morgan & Company advised the Van Sweringens that the collateral would be sold at public sale (R. 158). Public announcement was made September 13, of the auction to be held September 30, 1935 (R. 159). This was by publication of notices of sale in New York City newspapers; and except for notice to O. P. and M. J. Van Sweringen, was the only notice of the auc-

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* Record references to the paragraphs of the Stipulations where exhibits to Stipulations were introduced are referred to as Stip. .....

tion sale which was given to stockholders or creditors of Van Sweringen Corporation. The notice of sale divided the collateral into four groups along the lines of the previous plans and the Van Sweringen letter of July 20, groups 1 and 3 (which Midamerica purchased at the auction sale) comprising the securities which related to and constituted control of the Van Sweringen enterprises (R. 58, 240 offered 219, 229 offered 212, 188 offered 158 Stip. 18E).

Between the time that J. P. Morgan & Company first advised the Van Sweringens of the public sale and the public notice on September 13, 1935, to-wit: on August 10, 1935, the Van Sweringens contacted George A. Ball (R. 27-28). The result was the option agreement of September 21, 1935 (R. 66 offered 28 Stip. 18), which contained the essential elements of the plans which the Van Sweringens had made prior to their meeting with Ball (R. 186 offered 158 Stip. 18D, 229 offered 212, 239 offered 219, 240 offered 219, 253 offered 219).

Although this option agreement has the form of a letter from Ball and Tomlinson to the Van Sweringens, dated September 21, accepted by the latter on September 30, practically all of its terms had been agreed upon by August 15 and it was drafted by the Van Sweringens' own attorney, who also attended to the incorporation of Midamerica (R. 28, 216).

It provided, among other things, that a corporation should be formed to purchase portions of the collateral to be sold by J. P. Morgan & Company and that Ball and Tomlinson should purchase $2,000,000.00 of preferred and $15,000.00 of common stock of that corporation. The agreement further provided that O. P. and M. J. Van Sweringen were to have the sole and exclusive right to vote 55% of the common stock during a period of ten years and that during such time they were to have an irrevocable option, without the right of assignment, to purchase 55% of the common for $8,250.00, plus interest at 5% per annum

"at any time after you shall have satisfied at least five of the six directors of such corporation that you (in keeping with your expressed desires) have paid or adjusted any and all claims based upon now *existing commitments or relationships that may now or hereafter become enforcible against you." (R. 67.)

Hence, without having to pay one cent down, by this agreement the Van Sweringens (a) secured control of the voting stock for a period of ten years, with the additional right (b) to become the owners of said stock and thereby to share in any profit made upon securities acquired, on payment of the trifling sum of $8,250.00, plus 5% interest, and (c) all through a non-assignable, personal option which their creditors could not touch.

It was also agreed that O. P. and M. J. Van Sweringen should have a drawing account from Midamerica of $100,000.00 per year (R. 143), which sum the Van Sweringens were paid. This agreement likewise followed the earlier plan of O. P. Van Sweringen (R. 186 offered 158 Stip. 18D).

The original Board of Directors was selected by the option agreement of September 21, 1935 (not by Ball and Tomlinson, as alleged in the brief of petitioner), it being specified that three of the six directors should be O. P. Van Sweringen, M. J. Van Sweringen and their associate C. L. Bradley (R. 67 offered 28 Stip. 18). Prior to the auction sale they were so elected directors and were also elected to the principal offices of Midamerica, all of the other offices being filled by members of the Van Sweringens' organization (R. 29).

This Board of Directors of Midamerica authorized O. P. Van Sweringen to attend the auction sale and

"either personally or through such nominee as he may designate to bid for and purchase all or any part of the securities included within said Group 1 and/or said

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* Petitioner's brief at page 6 enlarges this condition to "existing *or future* commitments or relationships."

Group 3 at such price and prices as he may determine." (R. 29, 73 offered 29 Stip. 23).

Following the sale O. P. Van Sweringen reported back to the Board that Midamerica had purchased groups 1 and 3 (R. 77).

The indicated market values of the listed securities only, which Midamerica purchased at the auction sale, were $5,745,219.00 on the day of the sale.*

These securities included control of Alleghany Corporation (R. 165-166). For these listed securities and also for the many unlisted securities of the Van Sweringen interests, including also the notes which are the subject of this claim, Midamerica paid a total of only $3,121,000.00.

Midamerica allocated $887.00 of the purchase price to these notes of Van Sweringen Corporation (R. 108 offered 31 Stip. 28). The meeting of shareholders of Midamerica held May 24, 1938 specifically approved a report which showed that the "cost" of those notes was $887.00 (R. 162). In computing income tax on sales of other securities purchased at the auction sale the cost which Midamerica had similarly allocated to such other securities was used (R. 32).

Petitioner originally denied, but now admits, that Van Sweringen Corporation was insolvent at the time of the auction sale. At the same time C. T. B. was indebted to Van Sweringen Corporation for more than $27,000,000.00, had income which was not subject to pledge and responded to demands made from time to time by Van Sweringen Corporation for partial repayments both before and after the purchase by Midamerica of these securities. The repayments so made by C. T. B. were more than sufficient to enable Van Sweringen Corporation to make the purchase at the price paid by Midamerica (R. 33).

Midamerica purchased and retired all of its preferred stock at par (R. 161).

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* The tabulation in Appendix A of Petitioner's Brief states that items 12-16 and 18-28 of Group 1 had "no market value." This goes entirely outside the record, which contains nothing whatever about the market value of those items.

No common stock of Midamerica was issued and no meeting of shareholders was had until after the death of O. P. and M. J. Van Sweringen (R. 151).

After Midamerica had sold part of the securities acquired at the auction for $2,524,895.00 (R. 32), George A. Ball made a gift to the George and Frances Ball Foundation of 14,050 out of the 15,000 shares of common stock of Midamerica (R. 161). The George and Frances Ball Foundation then sold either this common stock or an equivalent 93-67/100% interest in the assets of Midamerica to Messrs. Young, Kolbe & Kirby for approximately $6,000,000.00 (R. 161, 194 offered 161 Stip. 27).

Although the Van Sweringens guaranteed the Vaness and C. T. B. loans, they never paid anything under those guarantees, nor did they compromise their liabilities thereunder, nor secure any release therefrom (R. 149).

Van Sweringen Corporation, controlled by the Van Sweringens, made no bid at the auction sale on September 30, 1935, and took no corporate action to authorize a bid (R. 165). O. P. and M. J. Van Sweringen never notified the creditors or stockholders of Van Sweringen Corporation that they intended to purchase these notes of Van Sweringen Corporation on behalf of themselves and their associates in Midamerica (R. 159).

At no time after the auction sale did Midamerica offer to Van Sweringen Corporation any opportunity to acquire said $13,787,000.00 principal amount of Van Sweringen Corporation notes (R. 33).

I.

THE COURTS BELOW CORRECTLY APPLIED THE DECISIONS OF THIS COURT.

Petitioner asserts that the courts below were "overzealous" in their application of *Pepper vs. Litton*, 308 U. S. 295. We submit that, in view of the evidence and the findings above set forth, the courts below reached the only possible conclusion and correctly applied both the letter

and the spirit of *Pepper vs. Litton.* The gist of that decision is that a trustee cannot serve two masters; that a fiduciary will not be permitted to profit at the expense of his *cestui que trust,* and that if he puts himself in a position where his self-interest conflicts with his fiduciary duty, his self-interest must give way, even though it means personal loss. This rule is basic and cannot be disregarded by reason of any guarantees or other contracts which the trustee may later make with third persons.

The Van Sweringens were not only officers and directors of Van Sweringen Corporation, and therefore fiduciaries, but were also in control of the corporation; and under the doctrine both of *Pepper vs. Litton* and of *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, upon which petitioner also relies, their acts are subjected to "more severe scrutiny and their validity determined by more rigid principles of morality, and freedom from motives of selfishness" than if they were not in such control.

Applying these principles to the facts here present, the Van Sweringens must stand condemned. They placed their self-interest in endeavoring to make a profit ahead of their duty to their corporation. It makes no difference that they died before they were able to realize the profit. The attempt to prefer their own interests above those of their *cestuis* was enough. As the Sixth Circuit Court of Appeals said (R. 328):

> "It is apparent here that the cupidity of persons in a fiduciary position has caused them to serve themselves in preference to those whom it was their duty to serve. Such dereliction is forbidden by just principles of law."

In *Twin Lick Oil Co. v. Marbury,* the company was barred by its laches in waiting four years until the energy, skill and money which the purchaser invested in the property had made it profitable. The purchaser was a minority director who had paid a fair price and had acted in good faith throughout the transaction. In the present case there

is no laches chargeable against Van Sweringen Corporation, and as the Sixth Circuit Court of Appeals said (R. 326):

> "The evidence of manifest good faith of a director in dealing with his company revealed in *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, heavily depended upon by appellant, utterly distinguishes that case from the instant litigation."

In *Sanford Fork & Tool Co. v. Howe, Brown & Co. Ltd.,* 157 U. S. 312, also relied on by petitioner, the court likewise found that everything was done "in the utmost good faith" (page 317 of 157 U. S.). The corporation had given security but there had been no sale of the property, no purchase by the directors at an unconscionable discount and hence no issue before the court on the right to profit. The opinion recognized that directors of an insolvent corporation, who preferred themselves, would be held to account.

II.

THE CLAIMED CONFLICT WITH OTHER CIRCUITS.

A. Petitioner Did Not Rely Upon Those Decisions in the Sixth Circuit Court of Appeals.

Petitioner now claims that certiorari should be granted because of conflict with the decision of the Second Circuit Court of Appeals in re: *New York Railways Corporation,* 82 F. (2d) 739 and with the decision of the Fifth Circuit Court in *Arn v. Bradshaw Oil & Gas Co.,* 108 F. (2d) 125. Both of these cases were reported and available at the time the present case was submitted to the Circuit Court of Appeals for the Sixth Circuit. Yet petitioner did not cite either one of those decisions to the Sixth Circuit Court of Appeals.

At least as far as the *New York Railways* case is concerned this was not because petitioner was unaware of that case. In the District Court petitioner relied heavily upon the *New York Railways* case. But in its briefs and oral

argument in the Circuit Court of Appeals petitioner never once mentioned that case. Obviously petitioner at that time either thought so little of the *New York Railways* case that it omitted the case, or it deliberately withheld the citation from the consideration of the Sixth Circuit Court of Appeals in the hope of obtaining certiorari upon a purported conflict of decisions if defeated; and neither reason was fair to the court below.

An appellant is not entitled to be heard in this Court on questions not presented to the lower court. In *J. M. Robinson & Co. v. Belt,* 187 U. S. 41, the court said:

> "While it is the duty of this court to review the action of subordinate courts, justice to those courts requires that their alleged errors should be called directly to their attention and that their action should not be reversed upon questions which the astuteness of counsel in this court has evolved from the record. It is not the province of this court to retry these cases *de novo.*"

To the same effect:

Helvering v. Minnesota Tea Co., 296 U. S. 378.

By analogy a petitioner should not be heard to say that a decision of the court below is in conflict with an earlier decision of another circuit court of appeals without giving the court below the benefit of that authority and a chance to either follow or distinguish that authority.

B. There Is No Conflict.

Both of the cases upon which petitioner relies recognize the basic duty of a fiduciary, but do not conflict with the present decision because of the entirely different facts which were presented to those courts.

In the *New York Railways* case (1) the parent company did not have a majority on the subsidiary debtor's board of directors and therefore did not have control; (2) the court found that the failure of the debtor to buy

its own bonds was not due to any control or interference by the parent; (3) nowhere does it appear that the debtor was insolvent at the date its bonds were purchased; (4) the debtor was financially unable to buy up its bonds; and (5) the price paid by the purchaser was substantial and there was no unconscionable discount.

The facts in the present case are contrary to those in the *New York Railways* case in all of the above respects. All of them are covered by the findings below. Petitioner argues strenuously that the failure of Van Sweringen Corporation to act was due to its financial inability to purchase and not to the control which the Van Sweringens had. But in this respect it asks this Court to disregard the findings made and concurred in by all of the lower courts and to make a contrary finding of fact. Without such complete disregard of the findings of fact of the lower courts, there is no possible basis for claiming a conflict between the decision of the Sixth Circuit Court in this case, and the decisions of the Second Circuit Court and the Fifth Circuit Court upon which petitioner relies.

In *Arn v. Bradshaw Gas & Oil Company,* a bank, holding a first mortgage on the property of an oil company, foreclosed and, subsequent to the foreclosure, sold the property to a corporation formed by some of the second lien creditors, at an amount equal to the first mortgage. Some of those second lien creditors, to protect their interests, had placed directors upon the board of the old oil company when it first became financially involved. Such creditor directors were a minority of the board and all of them had resigned prior to the sale by the bank to the new corporation. Upon suit brought by shareholders of the old corporation, the court refused to set aside the sale, pointing out that the directors did not bring about the sale; that the creditor directors were in the minority and were not in control of the board; that at the time of the sale the old company was in the hands of a receiver; and that the resale

was started after the foreclosure was completed and was an entirely separate transaction. So far as appears, the price paid at the foreclosure sale was fair and the property was not bought at the tremendous and unconscionable discount that was present in the instant case. In all of these respects the *Arn* case materially differs from the instant case.

Where the asserted conflict is one of fact, it is not a basis for certiorari.

Houston Oil Co. of Texas v. Goodridge, 245 U. S. 440;
Wisconsin Electric Co. v. Dumore Co., 282 U. S. 813.

C. The Granting of the Writ Will not Aid in Administration of the Bankruptcy Act.

(1) There is no conflict between this case and the decisions in the Second Circuit Court and the Fifth Circuit Court which are discussed above. The principles applied by all three courts are clear and the conclusions reached depend upon the facts as found in each case.

(2) This is not a case under either Section 202 of Chapter X or Section 212 of Chapter X but is one involving long established principles of equity. A decision by this Court in this case would not influence the interpretation and application of those provisions of the Bankruptcy Act to cases arising under those provisions.

III.

THE DECISION BELOW DOES NOT CONFLICT WITH ANY RELEVANT EXISTING STATE LAW.

On the assumption that state law governs (which we do not concede) petitioner argues that the applicable law is either that of New York or of Delaware. In either case, this would be no ground for granting certiorari.

A. New York.

Here petitioner relies entirely upon *Tiffany v. Smith*, 124 N. Y. S. 85. In that case it was held that the suit was

barred by laches, and no showing was made that the company had the means to purchase or that the price paid by the endorser was inadequate. Also, in that case a director was purchasing the assets of the company whose obligation he had endorsed, and not the notes of another company to whom he owed a fiduciary duty as a director of that company.

The principles of law which are applicable to the facts of this case have been clearly set forth by the state and federal courts in New York in the following decisions which were relied upon by the courts below and which are completely in accord with the decision of this case:

Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1;

Lonsdale v. Speyer, 291 N. Y. S. 495, 249 App. Div. 133 (1936);

Irving Trust Co. v. Deutsch, 73 F. (2d) 121 (2 C. C. A. 1934);

In re: McCrory Stores Corp., 12 F. Sup. 267 (S. D. N. Y. 1935).

B. Delaware.

We disagree with petitioner's statement that there is no relevant decision in Delaware and respectfully refer the Court to the decision of the Supreme Court of Delaware in *Guth v. Loft, Inc.,* 5 A. (2d) 503, affirming 2 A. (2d) 225. The Supreme Court of Delaware there conceded that when a business opportunity comes to a corporate officer or director and is of a nature which is not essential to his corporation and which involves no conflict with its interests, he can embrace it for himself, but the court continued (page 511):

> "On the other hand, it is equally true that, if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advan-

tage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself. And, if in such circumstances, the interests of the corporation are betrayed, the corporation may elect to claim all of the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired. *Du Pont et al.*, D. C. 242 F. 98, reversed on facts, 3 Cir., 256 F. 129; *Beatty v. Guggenheim Exploration Co.*, 225 N. Y. 380, 122 N. E. 378; *Irving Trust Co. v. Deutsch*, 2 Cir. 73 F. 2d 121, certiorari denied *Biddle v. Irving Trust Co.*, 294 U. S. 702, 55 S. Ct. 405, 79 L. Ed. 1243; *Bailey v. Jacobs, supra; Beaudette, et al. v. Graham et al.*, 267 Mass. 7, 165 N. E. 671; *McKey v. Swenson*, 232 Mich. 505, 205 N. W. 583."

Even if this decision had not been made and we were remitted to the entire body of substantive law, as petitioner suggests, the decision below is clearly in line with the great weight of authority.

In re: Norcor Mfg. Co., 109 F. (2d) 407 (7 C. C. A. 1940) Certiorari Denied 310 U. S. 625;

Price v. Comstock, 121 Fed. 620, 61 L. R. A. 176 (8 C. C. A.);

Canton Roll & Machine Co. v. Rolling Mill Company of America, 168 Fed. 465 (4 C. C. A.);

Dunnett v. Arn, 71 F. (2d) 912 (10 C. C. A.);

Beaudette v. Graham, 165 N. E. 671 (Mass.);

Bonney v. Tilley, 109 Cal. 346, 42 Pac. 439 (1895);

Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362, 386 (1895);

Farwell v. Pyle-National Electric Headlight Co., 289 Ill. 157, 124 N. E. 449 (1919);

Brewster v. Stratman, 4 Mo. App. 41 (1877);

Lingle v. The National Insurance Co., 45 Mo. 109 (1869).

CONCLUSION.

It is respectfully submitted that the purported conflict between the decision below and the decisions of the Second Circuit and of the Fifth Circuit is one in facts only. There is no conflict with either the decisions of this Court, the state law or the general decisions in this matter. All three of the lower tribunals have concurred in the facts, which facts are amply supported by the record. Petitioner's whole position is hinged upon a disregard of those findings by this Court. There is no question presented that is of great general or public interest and the petition for certiorari should be denied.

Respectfully submitted,

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(20)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613

IN THE MATTER OF
THE VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY (FORMERLY MIDAMERICA CORPORATION),
Petitioner,

vs.

VAN SWERINGEN CORPORATION,
Debtor,

and

FREDERICK L. LECKIE AND JOSEPH G. FOGG,
TRUSTEES OF VAN SWERINGEN CORPORATION,
Respondents.

(A. B. GOCHENOUR, ET AL., *Intervenors.*)

BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

The Circuit Court of Appeals affirmed the judgment of the District Court which adopted the recommendation of the Special Master and allowed Petitioner's claim in the sum of $887 with interest at 6% per annum from Octo-

ber 1, 1935, and denied the balance of the claim in excess of $17,000,000, on the ground that Midamerica was a combination in corporate form, participated in by directors of the respective debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against them at a sacrifice for the profit of the combination at the expense and to the detriment of the insolvent debtor corporations; that there was bad faith and breach of fiduciary duty; that Midamerica acquired and holds the notes so purchased by it as trustee for the debtor and therefore is not entitled to more than $887, the amount paid, together with interest thereon.

Corrections in Petitioner's Statement of Questions Presented.

Based upon petitioner's assumption that "it stands in the shoes of the Van Sweringens," the first question presented (p. 2) may be simplified: whether the Van Sweringens who dominated and controlled the insolvent corporations, acquired title other than as trustee for the benefit of the creditors of the debtor corporations, in the purchase of collateral securities at a pre-arranged sale whereby the Van Sweringens were to purchase the securities for their own benefit, without notice and opportunity to the creditors of their insolvent corporations to bid at such sale. In the second question (p. 3) the words *"where the director did not seek and could not make a profit"* should be eliminated for the reason that the Special Master found (R. 132) that the Van Sweringens purchased the securities *"at a sacrifice and for the profit"* and "at the expense and to the detriment of the Van Sweringen Corporation" and the District Court, in affirming the Master's finding, found (R. 271) that the Van Sweringens *"stood to profit under their option, as there were some very valuable securities in the lots pur-*

chased'' and *''they were to receive, and did receive, substantial money payments as agreed compensation for managing Midamerica,''* which compensation was $1,000,000 for the 10-year period. The court said (p. 271):

> "To hold that the Van Sweringens received no personal profit or advantage over these debtors, of their own creation, and to which they owed the highest fiduciary relationship, would be to disregard the express provisions of the purchase and option arrangement, the substantial compensation paid, and the necessary implications of the consequent corporate set-up."

In affirming the decision of the Master and of the District Court, the Court of Appeals said (R. 324):

> "It is conceded in the record that 'it was agreed and arranged with the Van Sweringens that by way of salary they were to have a drawing account of $100,000 per year' from the Midamerica Corporation.
>
> "Thus, as a result of their contract with Ball and Tomlinson, consummated by the aforementioned letter, the Van Sweringens, without investing a penny in Midamerica Corporation which purchased at the auction sale the notes and bonds of the debtors with which we are concerned, acquired voting control of Midamerica for a period of ten years and an option to buy 55% of its stock for $8,250 plus five per cent interest; and also assured themselves of an income, from the new corporation of $100,000 per year for the ten year period."

In view of the foregoing, the second question presented by petitioner (p. 3), wherein it is asserted that "the director did not seek and could not make a profit," is not fair or warranted by the record. The second question therefore is:

> In a reorganization proceeding under section 77B, should the rule which forbids a director to profit at the expense of his insolvent company by buying up its notes for a nominal price be applied in a case where the director sought and obtained a profit to himself, without giving the opportunity to the creditors of the

insolvent corporation to bid at the sale, and to enable the director to establish a claim in excess of $17,000,000 for the securities purchased and carried on his books at cost of $887, and should the decision of a Master, approved by the Court and affirmed by the Court of Appeals denying the profit to such a director, be reviewed by the discretionary Writ of Certiorari of this Court?

The statement (pp. 3-4) that in October, 1930, Vaness and C. T. B. "were in a serious need of funds" and the Van Sweringens obtained two loans of $16,000,000 and $23,500,000 from Morgan, and personally guaranteed these loans, is an inaccurate statement. *The loans were not obtained for the corporations* because they were in serious need of funds, but *were obtained for the benefit of the Van Sweringens, who were in serious need of funds, and the corporate credits were used for the purpose of obtaining the loans which were guaranteed by the Van Sweringens personally.* At the date of these loans, the Van Sweringens personally were obligated to maintain $15,000,000 "liquid securities" under *their* personal agreements pertaining to the $30,000,000 note issue. (R. 173-4.) These "liquid securities" which were secured by Alleghany stock shrank in value and it was necessary to substitute different securities. The loans were obtained in order to exchange the Alleghany stock for government bonds which were purchased out of the proceeds of those loans.

It was for such purpose that the Van Sweringens caused C. T. B. to execute the $23,500,000 note to purchase the $500,000 Alleghany stock and to substitute the stock with cash and government securities which was found by the Circuit Court of Appeals in another appeal taken by these intervenors to have been *tinged with fraud.* (*Gochenour* v. *J. P. Morgan & Co.*, 111 F. (2) 378.)

The statement (p. 5) that at the maturity of the notes Vaness, C. T. B. and the Van Sweringens admitted their

inability to pay and that Morgan published a sale on September 13, 1935, to be held September 30, 1935, omitted to state that the admission was made by the Van Sweringens for the purpose of having a sale held *so that they could purchase the collateral for their personal benefit,* as more fully appears from the private correspondence which is in the record. (R. 188, 190, 191.)

Midamerica not only was formed for the purpose of "bidding at the sale" but it was formed under the *preconceived plan* of the written agreement (R. 67) to elect the Van Sweringens as the chief officers of Midamerica with a salary of $100,000 per year for 10 years, and an option to purchase 55% of the common stock. The statement (p. 6) that the option was of no particular benefit as the Van Sweringens could not have elected a majority of the Board of Directors is untrue for the reason that *the Van Sweringens had elected themselves as the chief managing officers of Midamerica and they had one-half of the directorate.* The provisions which called for a change in the management by a vote of five out of six *perpetuated the Van Sweringens in control of this corporation.*

Reasons for Denial of the Writ.

1. The decision below is not in conflict with the decision of the Second Circuit.

2. The decision below is not in conflict with any decisions of state law.

3. The decision below does not conflict with applicable decisions of this court and with the decision of the Fifth Circuit.

4. The decision below followed the rule announced by this court pertaining to the duties of loyalty by fiduciaries.

ARGUMENT.

1. The Decision Below Is Not in Conflict With the Decision of the Second Circuit.

The contention (pp. 11-12) that the decision is in conflict with the decision of the Second Circuit in *In re New York Railways Corporation*, 82 F. (2d) 739, is devoid of merit. The District Court distinguished that case (R. 271) on the ground that there "no fiduciary relationship" existed, while here a *fiduciary relationship existed.* There "a management of independent directors" existed, while *"Here, the Van Sweringens dominated and controlled the debtors." New York Railways* case was also distinguished in *Ripperger* v. *Allyn*, 25 F. Supp. 554. There the court said (p. 555):

> "Directors and those who occupy a similar relation to a corporation may buy up claims held by strangers against it or may purchase from others liens on corporate property without accountability for profits, when the transaction is fair to the corporation and involves no competition with it. The prohibition applicable to strict trustees does not cover such a case. *In re New York Railways Corporation*, 2 Circ., 82 F. 2d 739; *Seymour* v. *Cemetery Assn.*, 144 N. Y. 333, 39 N. E. 365, 26 L. R. A. 859; see *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587, 23 L. Ed. 328; *McKittrick* v. *Arkansas Central Railway*, 152 U. S. 473, 14 S. Ct. 661, 38 L. Ed. 518. **There is no immunity, however, where the failure of the debtor company to buy up the claims for itself was brought about by the fact that the directors or others in control wished to acquire them for themselves. This, as I see it, is the substantial distinction between the Deutsch Case and the New York Railways Case,** both decided recently by the Circuit Court of Appeals of this circuit." (Emphasis supplied.)

(a) The contention (p. 12) that "Midamerica did not buy the notes for $887" is equally without merit. Midamerica not only carried these notes at "cost" on its books in the sum of $887 (R. 109) but *used its bookkeeping entries for the purpose of "substantiating" the cost before the Federal Income Tax Department.* (R. 106.) Whether or not the $887 was the real cost, is of no importance as Midamerica, standing in the shoes of the Van Sweringens, *had the burden to show the real cost* as stated in *First Trust & Savings Bank* v. *Iowa-Wisconsin Bridge Co.*, 98 F. (2) 416. There the Eighth Circuit said at page 425:

> "The rule for the guidance of the court in passing upon all these transactions was stated by the Supreme Court in *Geddes* v. *Anaconda Mining Co.*, 254 U. S. 590, 599, 41 S. Ct. 209, 212, 65 L. Ed. 425, as follows: 'The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and **where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration.** Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded *in soundest morality,* and we now add in the soundest business policy. *Twin-Lick Oil Co.* v. *Marbury,* 91 U. S. 587, 588, 23 L. Ed. 328; *Thomas* v. *Brownville, Ft. Kearney & Pacific R. Co.*, 109 U. S. 522, 3 S. Ct. 315, 27 L. Ed. 1018; *Wardell* v. *Railroad Co.*, 103 U. S. 651, 658, 26 L. Ed. 509; *Corsicana National Bank* v. *Johnson*, 251 U. S. 68, 90, 40 S. Ct. 82, 64 L. Ed. 141.' *Compare McCandless* v. *Furland*, 296 U. S. 140, 158, 56 S. Ct. 41, 46, 80 L. Ed. 121." (Emphasis supplied.)

Abundant authorities are cited on this point that *the burden to show fairness of the purchase price is on the directors.* (76 A. L. R. page 458.)

(b) The fact that in the Morgan appeal the court found that the sale should not be set aside in so far as the *seller* was concerned (111 F. (2d) 378) has no bearing on the question whether Midamerica, standing in the shoes of the Van Sweringens, as the *purchaser*, acquired the assets at the sale in good faith. The Morgan case involved the validity of a sale by a *creditor* who had *no fiduciary relationship* to the corporation and is not charged with knowledge of the intrinsic value of the securities. In that case the objector had the burden to sustain the charge of fraud. Here the claimant, *a fiduciary*, sought to establish a claim in excess of $17,000,000 for property which it carried on its books at cost of $887. The purchaser, *an insider, had actual knowledge of the value of the securities which later yielded a profit of $6,000,000.* The value of these securities to the Van Sweringens or Midamerica, whereby the control of the chain of railroads was obtained, stands in a different category.*

It is on this point that the *Twin-Lick* case is distinguished in 76 A. L. R. 448 where the author points out that there *"no advantage was taken of defendant's position as director nor was any matter known to him at that time of the sale, affecting the value of the property, that was not well known to others interested as it was to himself."*

(i-iii). The argument of petitioner under Points (i-iii) (pp. 15-19) are designed to create "confusion" in rules which are plain and clear.

2. The Decision Is Not Untenable and Is Not in Conflict With Any State Law.

The New York law on which petitioner relies for probable conflict is the rule announced in *Tiffany* v. *Smith*, 124 N. Y. Supp. 85, which petitioner says (p. 20) is "the only

* See Report No. 25 of Senate Committee under S. Res. 71, par. 25, entitled "Allegheny System—Midamerica Corporation."

New York case on the subject." That case involved a sale by a *receiver* and there was no question about failure to give notice to creditors, and the directors did not stand in a fiduciary position to creditors. The *Tiffany* case is cited in *Herring* v. *Curtiss*, 200 N. Y. Supp. 7, 48, on the point that the directors were absolved from a breach of the trust but that decision was *reversed* on appeal in 233 Appellate Division, page 101. The *Tiffany* case relied on, cited the decision in *Marr* v. *Marr*, 72 N. J. Equity 797, but it *overlooked* that the New Jersey Court of Errors *reversed* the decision in 73 N. J. Equity 797, 70 Atlantic, page 375. There it said (p. 378):

> "But we deem it clear that the director, who is also creditor, must, on taking legal proceedings for collection of his debt, relinquish his trust *pro hac vice*, not covertly, but openly, and with fair notice to his company. Whether such notice should be given to the stockholders or to the directors may depend upon circumstances. If the company is equipped with other officers and directors who are actively representing the interest of the stockholders, it may well be that notice to such officers or directors would be deemed sufficient. But it is, as we think, **inconsistent with the duty of a director** (at least under circumstances such as are here presented) **that he should assume an attitude antagonistic to his company, unless he sees to it that the interests of the stockholders, which he, by reason of his personal interest, is for the time disqualified from protecting, are in the charge of other officers** and directors able and willing to protect them, and to whom his notice may be given, **or else sees to it that fair notice of his contemplated action be given** to the stockholders, so that they may take measures to protect themselves."

The rule was followed in *Endicott* v. *Marvel*, 87 Atl. 230 and in *Union Ice Co.* v. *Hulton*, 291 Pa. 416, where the director purchased at a "public sale". In the latter case the Court cited the *Marr* case, *supra*.

Notwithstanding the statement that the *Tiffany* case is

the "only" New York case on the right of a director-creditor to purchase the property of his corporation to protect his creditor's position without notice to the corporation or to its creditors in the event of insolvency, *the contrary appears* in *Claude Neon Lights* v. *Fed. Electric Co.*, 295 N. Y. S. 1-6, 250 App. Div. 510 (1937). See also *Lonsdale* v. *Speyer*, 291 N. Y. S. 495, 249 App. Div. 133, cited in the opinion. (R. 325)

Even in cases where the director-creditor may become a purchaser in order to protect his creditor's position, he must "warn the corporation" that he would "bid" and afford it the opportunity to protect its rights. (*Wilson* v. *Thelan*, 100 P. (2) 923 (Mont. 1940).) There it was said (p. 927):

> "Where there is a forced sale of corporate property *a director who is also a creditor who warns the corporation that he is about to do so, may bid* upon the property without being charged improperly taking an interest adverse to the corporation." (Italics ours.)

No such "warning" was given in the instant case. The authorities on this point are collected in 76 A. L. R. pp. 454-455.

Why the law of Delaware should be applied as contended for (p. 20) is not disclosed. The question here is not whether the Delaware corporation acquired the assets in fraud of creditors but whether *the corporate officers who are residents of Ohio* acquired the assets in breach of *their* trust duties and obligations. At any rate, counsel confess that there is no Delaware decision on this point, and, of course, the decision therefore cannot be in conflict with state law which is non-existent.

3. The Decision Below Follows the Applicable Decision of This Court and Is Not in Conflict With the Decision of the Fifth Circuit.

The contention (p. 21) that the decision in the instant case is in conflict with the rule announced by this court in *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, which is reiterated in many places (pp. 24, 25, 26, 29), was raised below. It was disposed of by the District Court which said (R. 271):

> "Unlike *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, the debtors here acted as promptly to object to the effects of the purchase arrangement as was possible. Certainly, the Van Sweringens never would have raised objection, and with their death the debtors were left with no responsible independent officers until trustees were appointed by the Court. Unlike *Twin-Lick* v. *Marbury, supra*, the debtors or their creditors here never were given a chance to participate in the sale. No action ever was proposed or recorded in the minutes of the debtors that they were unable or unwilling to bid for the obligations and securities or any part of them."

The Court of Appeals' opinion distinguished it in the following language (R. 326):

> "The evidence of manifest good faith of a director in dealing with his company revealed in *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, heavily depended upon by appellant, utterly distinguishes that case from the instant litigation. Moreover, the Supreme Court said (Op. 588, 589): 'That a director of a joint stock corporation occupies one of those fiduciary relations where his dealings with the subject matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others.'
>
> "From the premise that the Twin-Lick Oil Company

case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantages not shared by all stockholders. See *Thomas* v. *Matthews*, 94 O. S. 32, 43."

In commenting on the *Twin-Lick* case in 76 A. L. R. 448, the author points out that there, the property was sold "at a fair and open sale and at a reasonable price; no advantage was taken of defendant's position as director." The court said in its opinion that the sale was made by a trustee "who had the required power necessary to see that the sale was fairly conducted, and who in this respect was the trustee of the corporation, and must be supposed to have been selected by it for the exercise of the power" and the corporation, therefore, was represented at the sale by an *independent* trustee. The opinion also pointed out that the stockholders had notice of the sale and "refused to join with the defendant in the purchase."

In a comment on the *Twin-Lick* case in *Beaumont* v. *Folsom*, Nebraska 1939, the court said (285 N. W. 547, 550) that the right of a director to purchase corporate property at the sale *to protect his creditor's position is subject to the giving of notice and opportunity to the corporation and the independent members of the board* "to participate in arranging the new corporation" which was to bid at the sale. No such notice or opportunity was given by the Van Sweringens to any independent persons.

Petitioner says (p. 22) that the *Twin-Lick* case stands for the "fair doctrine" that "where a director, acting throughout in entire good faith, acquires valid rights

against his company, he may take appropriate steps to protect those rights" and "Midamerica invokes this doctrine here." The misapplication of the doctrine is apparent. It was not "good faith" on the part of Midamerica, standing in the shoes of the Van Sweringens, to invite Morgan to sell the securities and to purchase the securities for themselves, and, after stripping the corporations of the valuable securities, to plunge their corporations into bankruptcy under 77B. Why did they not file the 77B proceedings prior to the sale and thereby enable the creditors to obtain the protection and aid of the bankruptcy court? Such a plan was suggested by the attorney for the corporations. (R. 254-255.) Such course would have placed the debtor corporation, and not the Van Sweringens, in control of the securities. It should also be noted that the Van Sweringens were *trustees for the creditors because of the insolvency of the corporations under the Ohio law.* This distinction was expressly made in *McCrory Stores Corporation,* 12 Fed. Supp. 267. The case was cited with approval in *Security First National Bank* v. *Rindge Land & Navigation Co.,* 85 F. (2d) 557, 562. If the New York law be applicable here as contended by petitioner, then, *the rule announced in the McCrory case* (12 F. S. p. 267) *was adopted in New York* (*Claude Neon Lights* v. *Federal Electric Co.,* 295 N. Y. S. 1, 250 App. Div. 510). There, the Court said (p. 517):

> "In Fletcher's Cyclopedia of Corporations (Permanent ed. § 869) it is stated that the general rule is that directors or other officers may purchase, and enforce, claims against their corporations, at their face value, notwithstanding they were bought at a discount, provided, however, that (1) if such officer owed the duty to his company to purchase the claim for the company instead of for himself he cannot enforce his claim in excess of what he paid for it, and, according to what is apparently held in a few decisions, that (2) if a corporation is insolvent at the time of the purchase the officer cannot enforce his claim for more than he paid

> for it. The rule is reiterated in *Matter of McCrory Stores Corporation* (12 F. Supp. 267), where it is said: 'Under ordinary conditions a director may purchase claims against his corporation at a discount and enforce them for their full amount. (*Seymour* v. *Spring Forest Cemetery Association,* 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; *Glenwood Mfg. Co.* v. *Syme,* 109 Wis. 355; 85 N. W. 432; Fletcher on Corporations, § 2289.) *But the case is different where the corporation is insolvent and is itself in the field to settle the claims. A director who acquires claims under such circumstances may enforce them for no more than the cost of acquisition.*' "

See also *Billings* v. *Shaw,* 209 N. Y. 265 and *Jno. Dunlop's Sons* v. *Dunlop,* 14 N. Y. S. (2) 452 (1940). There the Court said (p. 453):

> "Directors may not act in a dual capacity to their individual advantage. Silence when speech is imperative, concealment when disclosure is necessary, disloyalty when faithfulness is indicated, constitute breaches of fiduciary relationship for which relief in equity may be had."

Such relief was given under the rule that a court of bankruptcy is essentially a court of equity (*Pepper* v. *Litton,* 308 U. S. 295).

In Fletcher Cyc. (Perm. Ed.) in Section 876, after stating the general rule as contended here that an officer may purchase corporate property to protect his endorsement or guarantee, the author points out that *the rule is different where the corporation is insolvent* for by such purchase he, the officer, obtains a preference over the other creditors. In Section 7462 the author cites the Ohio Code, Section 11104, declaring void preferential sales in contemplation of insolvency. See also Section 7469 where the author says (p. 266):

> "*The denial of the right of directors of an insolvent corporation to obtain a preference* by way of security or payment of debts due them by the corporation *is not a rule founded upon the trust fund doctrine,* but

> upon the theory that *it is inequitable that a director,* whose position as to knowledge of conditions and power to act for the corporation gives him an advantage, *should be permitted to protect his own claim to the detriment of others at a time when it is apparent that all the unsecured debts of the corporation are equally in peril,* and that all of them cannot be paid. And some cases take the position that he is not even a creditor as against creditors having no connection with the corporation. However, it is the universal rule in those states which recognize the trust fund doctrine." (Italics ours.)

Ohio is *one of the States which recognizes the trust fund doctrine.* (*Hardware Co.* v. *Castings Co.*, 90 O. S. 171, 106 N. E. 966.) The Van Sweringens were in control of the subsidiary debtor, "its mind, hands and pockets," (*Rabinovitz* v. *Oughton*, 92 F. (2) 297), and were in duty bound to execute their function "with absolute fidelity to both creditors and stockholders" and they or their associates "will not be allowed to secure to themselves advantages over creditors."

The assertion (p. 22) that "the Van Sweringens in good faith lent *their* credit to Vaness" is contrary to the findings of the Master, approved by the District Court and confirmed by the Court of Appeals. The court said (R. 275):

> "The Van Sweringens had caused these notes and bonds to be issued and had hypothecated them with Morgan *to secure their own borrowing* and the debtor's obligations to Vaness Company, their personal and top holding company."

The statement (p. 22) that Vaness "purchased from the public $13,787,000 of the debtor's notes for approximately $7,000,000 in cash" is unfounded. Vaness did not purchase these notes in the open market. It did not pay $7,000,000 in cash. The record shows that these notes were purchased by the Van Sweringen Corporation and not by Vaness. (R. 48.) The cash was not paid by Vaness but was taken out of the "segregated assets" and "assigned securities"

which *belonged to the noteholders*, and the common stock in exchange of the balance of the notes was also furnished by Van Sweringen Corporation and not Vaness. It is true that after these notes were so acquired they were placed by Vaness with Morgan as additional security for its existing loan, as it is shown by its agreement with Morgan prior to the acquisition of these notes. (R. 51-55.) It was very easy for O. P. Van Sweringen, who was then President of the Van Sweringen Corporation and President of Vaness, to take the notes and place them as collateral with Morgan, but this did not vest the title in Vaness as the notes were acquired by Van Sweringen Corporation.

On the one hand petitioner argues (p. 23) that the Van Sweringens had the right to purchase the assets, to reduce their obligation on the guarantee, and on the other hand it is argued (p. 23) that the Van Sweringens "were hopelessly insolvent" and owed in excess of $50,000,000. How did the purchase of the assets help them to reduce their obligation and to place them in a sounder financial position when a deficiency was obtained in excess of $27,000,000?

The contention (p. 24) that the decision is in conflict with the decision of the Fifth Circuit in *Arn* v. *Bradshaw Oil and Gas Co.*, 108 F. (2) 125, is unsound for the reason that the court recognized the rule which forbids a director to purchase the property of his corporation but it said "the application of the principles here fails, because the directors did not misuse their position to obtain the challenged results, and because they have not personally obtained the property of the company." It pointed out that the directors had "ceased" to be directors by their prior resignations and the company had notice and was represented by the receiver. The *Twin-Lick* case was cited on the point that a director may buy at "a clean judicial sale" where the sale is "fair." The *Arn* decision is, therefore, not in conflict with the instant decision.

4. The Decision Below Properly Applied the Rule Announced in Pepper v. Litton, 308 U. S. 295, and Was Founded on Well Settled Equitable Principles Relating to Duties of Loyalty by Fiduciaries.

The contention (p. 26) that the decision over-zealously applied the rule in the *Pepper* case and that, instead of enforcing vigorously a director's duty of loyalty, the effect of the opinion will be precisely the opposite is fallacious. The effect of this decision will tend to prevent trustees from betraying their trust duties and will prevent combinations to defraud the innocent public.

Petitioner's contention (p. 27) that the decision of this court in the *Sanford* case (157 U. S. 312) is not in accord with the instant decision is groundless. In the quotation from the *Sanford* decision it appears that the court distinguished that case from the other cases on the ground that the directors lent their credit for the benefit of the corporation and that the corporations were "going concerns." The court also pointed out that the directors acted "in the utmost good faith." Here, the directors used the corporations for *their private purposes* to relieve themselves from their duty to keep $15,000,000 in "liquid securities" as part of their agreement to float a $30,000,000 note issue. (Ex. 1, R. 173.) *They plunged their corporations into enormous debt* in order to supply this $15,000,000, and are now seeking, in the name of Midamerica, to establish a claim in excess of $17,000,000 against the insolvent corporations, to the prejudice of bona fide creditors, after realizing over $6,000,000 in profits from the acquisition of the securities.

This court followed the rule announced in *Pepper* v. *Litton* in *Sampsell* v. *Imperial Paper & Color Corporation*, 313 U. S. 215, 61 S. Ct. 904, 85 L. Ed. 797. Mr. Justice Douglas, speaking on behalf of the court, stated (p. 218):

"Mere legal paraphernalia will not suffice to trans-

> form into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, **it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors.** *In re Schoenberg,* 2 Cir., 70 F. 2d 321; *In re Berkowitz,* D. C., 173 F. 1013. And see Glenn, Liquidation, §§ 30-32. Cf. *Shapiro* v. *Wilgus,* 287 U. S. 348, 53 S. Ct. 142, 77 L. Ed. 355, 85 A. L. R. 128." (Bold type supplied.)

Compare this with the opinion of the trial court in the instant case (R. 272):

> "Under the option and purchase arrangement, if the Van Sweringens died or failed to satisfy their creditors within ten years, Ball and Tomlinson took all. **It was a mutually satisfactory arrangement for their common protection against those who might try to pursue the Van Sweringen fortunes through the intricate maze of corporate entities.** Thus, it assured control to the Van Sweringens without creditor interference and gave to Ball and Tomlinson, their associates, freedom from the threat of stranger majority in control of the voting stock. **The option was just what it was intended to be, a device for placing the Van Sweringens' interests in the purchased securities and obligations beyond the reach of their and these debtors' creditors.**" (Bold type supplied.)

Conclusion.

It is clear that the decision of the United States Circuit Court of Appeals for the Sixth Circuit, in the instant case, followed the well settled applicable legal principles, universally accepted, in affirming the judgment of the District Court and the findings of the Special Master. Justice has been done in accordance with equity and good conscience.

The petition for writ of certiorari should, therefore, be denied.

Respectfully submitted,

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